



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Number: **201404013**  
Release Date: 1/24/2014

Date: 10/29/2013

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

UIL: 501.33-00; 501.36-00

Dear :

This is our final determination that you do not qualify for exemption from federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Since you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate state officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your state officials if you have any questions about how this determination may affect your state responsibilities and requirements.

Letter 4038 (CG) (11-2005)  
Catalog Number 47632S

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Kenneth Corbin  
Acting Director, Exempt Organizations

Enclosure  
Notice 437  
Redacted Proposed Adverse Determination Letter  
Redacted Final Adverse Determination Letter



**DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224**

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: August 28, 2013

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

**LEGEND:**

C = Non-profit Cooperative Grocery  
D = Community Grocery  
E = Non-profit Association  
O = State  
S = Date

**UIL:**

501.33-00  
501.36-00

Dear :

We have considered your application for recognition of exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code of 1986. Based on the information provided, we have concluded that you do not qualify for exemption under section 501(c)(3). The basis for our conclusion is set forth below.

**Issues**

- 1) Are you operated exclusively for exempt purposes as described in Section 501(c)(3) of the Code? No, for the reasons explained below.
- 2) Are private, rather than public, interests being served, therefore prohibiting you from qualifying for exemption under section 501(c)(3) of the Code? Yes, for the reasons explained below.

**Facts**

Letter 4036(CG) (11-2005)  
Catalog Number 47630W

You incorporated in the State of O on date S. Your Articles of Incorporation stated in part:

Should the Foundation need to be dissolved funds and property shall be surrendered to the (economic development commission). In the event this is not feasible, transfer of funds and property will go to a similar organization consistent with the Foundation provided it is exempt under Section 501(c)(3) of the Internal Revenue Code.

You subsequently amended your governing document to include the requisite section 501(c)(3) purpose clause and notwithstanding clause.

Section 2 of your bylaws lists your goals which are:

- A. Providing a year-round farmer based grocery store
- B. Providing a student-run restaurant using grocery store supplies
- C. Providing a cannery/freezing facility using grocery store supplies
- D. Providing a bakery, which will also provide goods to your grocery store and restaurant
- E. Providing a means of jar recycling

Article V of your bylaws states your potential outcomes as follows:

- A. Providing anyone a potential tax deductible contribution
- B. Providing the ability to receive "inheritance" or in-kind donations
- C. Providing an entity independent of government control to gain control of county-wide fiscal future
- D. Providing a venue for tourism
- E. Providing an educational resource
- F. Providing a sustainable economy

You are a membership organization. Membership requirements as mentioned in Article VII of your bylaws will consist of anyone who participates in the vending program including growers of any size, artisans, musicians or demonstrators.

Your website states that you were "...designed to feed our own, employ our own, and prosper."

You will initially create a locally owned, operated and, as much as possible, stocked grocery store. To counteract the erosion of your county's long and successful heritage as an agricultural center, you hope to take advantage of the "local food" movement by creating and successfully operating a community-based grocery store that will be open to the public. Your local market will support area farmers and craftspeople. You will sell primarily locally grown and produced merchandise including farm produce, value-added agriculture products and other local items at market rate. Eventually, you plan to expand your activities to include a restaurant that will serve locally grown or produced items as well as a commercial canning or processing facility that will use locally grown items as its source of raw materials. The aforementioned activities will accomplish the following:

- Create more income for local producers, which will enable them to stay on the farm.
- Set-up a self-sufficient network of businesses, which will bring more control and profitability back to local hands.

Your pamphlet indicates that your activities will be conducted by volunteers, students in companion programs, farmers, and locally hired individuals.

You will focus on the more northern section of your county, which is very dependent on farm income. Tobacco was your county's main cash crop and many manufacturing jobs have disappeared. You will target farms of all sizes and economic status. Your effort will affect a significant section of minorities particularly women who have been displaced due to loss of manufacturing jobs.

Although you will focus on and your activities will be conducted within your county, you plan to draw residents from eight surrounding counties to patronize your planned establishments.

You will not pay salaries to your officers or directors; however, they may receive compensation for goods sold at your store. The work experiences of your officers and directors include the following:

- Agricultural education teacher,
- Senior director of off-campus centers for a community college,
- County director of economic development,
- Research associate
- County commissioner who owns a business and a farm
- Accounting clerk with experience in sports marketing and store management.

Many of your area's youths and anyone else interested in providing products for the stores will be involved in the process. There will only be one class of membership. Benefits allow members to sell goods at the retail establishment and to be paid for goods sold. You expect to have approximately 100 members and charge nominal annual membership fees of about \$35 per member. You will sell members' products on a consignment basis. Members will be paid as their goods are sold. You will retain about 35% of the sales price as commissions.

You provided limited financial information on Page 9 of Form 1023. Page 9 indicates that all of your revenues will come from "Gifts, grants and contributions" yet your response indicates that products sold at your store will be your source of revenues. You submitted a revised Page 9, which reflects proposed annual revenues ranging from about \$5,000 to \$500,000. Your expenses include fundraising, occupancy and professional fees. Financial information indicates that there will be no net profits or losses.

Your executive director indicated you will be working with high school students; however, you provided no details relating to this activity. The executive director also indicated that your activity would benefit the community because the nearest grocery store is located twenty-five miles away. Internet research found that there are three grocery stores/markets located within

your zip code.

## Law

Organizations exempt under Section 501(c)(3) of the Code are defined as:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Treas. Reg. section 1.501(c)(3)-1(a)(1) provides that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Treas. Reg. section 1.501(c)(3)-1(b)(4) states that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the federal government, or to a State or local government, for a public purpose, or would be distributed by a court to another organization to be used in such manner as in the judgment of the court will best accomplish the general purposes for which the dissolved organization was organized.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations states: "An organization will be regarded as 'operated exclusively' for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose."

Section 1.501(c)(3)-1(d)(ii) of the Regulations states that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirements, an organization must establish that it is not organized or operated for the benefit of private interests, such as those of its creator.

In Revenue Ruling 61-170, 1961-2 C.B. 112, an association composed of professional private duty nurses and practical nurses which supported and operated a nurses' registry primarily to afford greater employment opportunities for its members was not entitled to exemption under section 501(c)(3) of the Code. Although the public received some benefit from the organization's activities, the primary benefit of these activities was to the organization's members.

In Rev. Rul. 71-395, 1971-2 C.B. 228, a cooperative art gallery formed and operated by a group

of artists for the purpose of exhibiting and selling their works does not qualify for exemption under section 501(c)(3) of the Code.

In Rev. Rul. 73-127, 1973-1 C.B. 221, the Service held that a nonprofit organization that operated a cut-price retail grocery outlet and allocated a small portion of its earning to provide on-the-job training for the hard-core unemployed did not qualify for section 501(c)(3) exemption.

In Rev. Rul. 74-587, 1974-2 C.B. 162, the Service held that an organization that devoted its resources to programs that stimulated economic development in economically depressed, high-density, urban areas, inhabited mainly by low-income minority or other disadvantaged groups, qualified for exemption under Internal Revenue Code section 501(c)(3).

In Rev. Rul. 76-94, 1976-1 C.B. 171, the Service held that an exempt organization's operation of a retail grocery store was not an unrelated trade or business. This particular activity was part of a therapeutic program for emotionally disturbed adolescents. It was staffed mostly by the adolescents and operated on a scale no larger than was reasonably necessary for the performance of the organization's exempt functions.

In Rev. Rul. 76-152, 1976-1 C.B. 151, the Service found that a nonprofit organization formed by a group of art patrons to promote community understanding of modern art trends by selecting, exhibiting, and selling art works of local artists, and which retained a ten percent commission on sales less than customary commercial charges but insufficient to cover the cost of operating the gallery, does not qualify for exemption under section 501(c)(3) of the Code. The ruling concluded that the direct benefits to artists cannot be dismissed as being merely incidental to other purposes and activities since ninety percent of all sales proceeds are turned over to the individual artists.

In Rev. Rul. 76-419, 1976-2 C.B. 146, the Service held that a nonprofit organization that purchased blighted land in an economically depressed community, converted the land into an industrial park, and induced industrial enterprises to locate new facilities in the park through favorable lease terms that required employment and training opportunities for unemployed and underemployed residents of the area, is operated exclusively for charitable purposes.

Rev. Rul. 77-111, 1977-1 C.B. 144, described situations of two separate organizations. One organization was formed to increase business patronage in a deteriorated area by providing information on shopping and a telephone information service on transportation and accommodations. To revive declining sales in a particular area, another organization purchased land for the construction of a retail center. Neither organization qualified for exemption under IRC 501(c)(3) because the overall thrust was to promote business rather than to accomplish exclusively 501(c)(3) objectives.

Better Business Bureau of Washington, DC, Inc. v. United States, 326 US 279 (1945), holds that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

The applicant for tax-exempt status under section 501(c)(3) has the burden of showing it "...comes squarely within the terms of the law conferring the benefit sought." Nelson v. Commissioner, 30 T.C. 1151 (1958).

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services was not exempt under section 501(c)(3) because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, nor scientific, but rather commercial. Additionally, the court found that the organization's financing did not resemble that of the typical 501(c)(3) organization. It had not solicited or received voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs and to produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than "cost." Finally, the corporation did not limit its clientele to organizations that were section 501(c)(3) exempt organizations.

Senior Citizen Stores, Inc. v. U.S., 602 F.2d 711 (5th Cir 1979) described an organization that was to provide training, jobs, places of recreation to the elderly and to improve their physical and mental conditions. It operated three retail stores, which sold used clothing, furniture and household appliances to the general public. No training program was conducted beyond the training of employees for the shops. No health care or housing facilities were provided. The court found that it was neither a charitable nor educational organization because the retail sales operation was an end in itself rather than a means of accomplishing a charitable goal.

Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991) involved an organization established by the Seventh Day Adventist Church to carry out its "health ministry" through the operation of two vegetarian restaurants and health food stores. The court sustained the IRS's denial of exemption under section 501(c)(3) of the Code because the organization was operated for a substantial non-exempt commercial purpose. The court found that the organization's activities were "presumptively commercial" because the organization was in competition with other restaurants, engaged in marketing, and generally operated in a manner similar to commercial businesses.

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the court relied on the "commerciality" doctrine in applying the operational test. The court found that the organization was operated for a non-exempt commercial purpose because of the commercial manner in which this organization conducted its activities. "Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, inter alia, whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations."

### **Application of Law**

You are not described in section 501(c)(3) because your assets, as stated in your articles, are

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Catalog Number 47630W



not dedicated to an exempt purpose as required by Treas. Reg. section 1.501(c)(3)-1(b)(4).

You are also not described in section 501(c)(3) because you do not meet the operational test as described in section 1.501(c)(3)-1(c)(1) of the Regulations. You failed to demonstrate that your operations will carry out exempt purposes of Code section 501(c)(3). You have not established that your activities further exclusively charitable purposes.

You are not described in Regulations section 1.501(c)(3)-1(d)(ii) because you will be providing a venue for local farmers and vendors to sell their products. By doing so, you will be operating for more than insubstantial private benefits of the farmers and vendors.

You are similar to Rev. Ruls. 61-170 and 71-395 in that your members, including farmers and vendors, privately benefit from your operations.

You are similar to the organization described in Rev. Rul. 73-127 because your activities of operating a grocery store, restaurant, bakery, etc. do not further a charitable purpose. You indicate that you will conduct educational activities; however, the lack of information pertaining to this particular activity as well your operation of a store, restaurant, bakery, etc. indicates that it will not be your exclusive activity.

You are unlike the organizations described in Rev. Ruls. 74-587 and 76-419 because even though your operation of a store, restaurant, bakery, etc. may benefit low-income or other disadvantaged groups or may encourage new enterprises to relocate to your area, you have a more than insubstantial purpose.

You are unlike the organization described in Rev. Rul. 76-94 because your activity of operating a grocery store is not part of a therapeutic program and you operate on a scale larger than necessary to accomplish an exempt purpose.

You are similar to the organization described in *Situation 1* of Rev. Rul. 77-111 in that your overall thrust is to promote business rather than to accomplish exclusively 501(c)(3) objectives. You are also similar to the organization described in *Situation 2* of Rev. Rul. 77-111 in that your organization's activities are directed to your membership. As stated above, membership in your organization consists of anyone who participates in the vending program, including growers of any size.

Similar to Better Business Bureau of Washington D.C., Inc. v. United States, Airlie Foundation v. Commissioner, B.S.W. Group, Inc. v. Commissioner, Living Faith, Inc. v. Commissioner, you do not qualify under section 501(c)(3) because you will operate for the substantial non-exempt purposes of managing and operating a grocery store, a cannery and jarring facility, a bakery, and a restaurant, in a commercial manner. Most of your revenues will come from the sales of goods. You will be in direct competition with for-profit businesses that perform identical activities.

Similar to Senior Citizen Stores, Inc. v. U.S., your operation of a grocery store, restaurant, etc. are an end themselves rather than a means of accomplishing a charitable goal.

Similar to Nelson v. Commissioner, you have not met the burden of showing that your grocery store, bakery, cannery/jarring, and restaurant activities qualify for exemption under section 501(c)(3).

### **Applicant's Position**

Your primary goal is to address the issue of your county as being a "food desert" and to assist the large farming population's economy convert from tobacco cash crops to food crops. You or your board members do not intend to profit from your project. You indicate that there are many examples of similar grocery stores operating as nonprofits throughout the nation. You provided the names and activities of three that you plan to model yourself after as follows:

- C - is a nonprofit, cooperatively run food store that is open to the public. Members receive a 5% discount and working members (3 hours per month) receive a 15% discount.
- D - was opened "out of a real absolute necessity" with no intention of owning a grocery store.
- E - will sell locally grown and raised produce, dairy, honey, meat and other products.

Besides operating a grocery store, you will educate your farmers and local citizens in self-sufficiency and all profits will be reinvested towards the venture's growth. You do not intend to create income for your members. You indicated that you should have provided a description of a separate class of vendors not members that will be providing goods for sale in the proposed store.

### **Service Response to Applicant's Position**

Each determination of exempt status is based on the unique set of facts and circumstances for the particular applicant. Accordingly, the determination of exemption for one (C, D or E) cannot be used as the basis for determining qualification for another (you).

Regarding your claim that you will educate farmers and local citizens to be self-sufficient, the facts show education is not your exclusive purpose. You indicate that you have no plans to create income for your members; however, your response indicates that payments made to members for consigned items sold "is substantially more income than they can receive from any commercial buyer, thus creating more income for local producers and increasing their ability to stay on the farm."

Considering that your membership will consist of anyone, who participates in the vending program including growers of any size, artisans, musicians or demonstrators, you have not established your operations will further charitable and/or educational purposes. Instead, your programs result in more than insubstantial private benefit to your members.

You do not qualify as a charitable or educational organization as described under section 501(c)(3) of the Code because you will operate in a commercial manner, benefiting your members through consignment sales.

## Conclusion

Based on the information presented, you do not qualify for exemption under section 501(c)(3) as a charitable or educational organization or under any other section within the Internal Revenue Code. You are not organized and operated exclusively for exempt purposes as described in Section 501(c)(3) or any other subsection of the Code for the following reasons:

- Your activity of operating a grocery store and related ventures do not further exclusively section 501(c)(3) purposes.
- Private benefit exists because you will provide members/sellers opportunities and venues to sell their products through consignment.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*.

Types of information that should be included in your protest can be found on page 2 of Publication 892, under the heading "Filing a Protest". These items include:

1. The organization's name, address, and employer identification number;
2. A statement that the organization wants to protest the determination;
3. The date and symbols on the determination letter;
4. A statement of facts supporting the organization's position in any contested factual issue;
5. A statement outlining the law or other authority the organization is relying on; and
6. A statement as to whether a hearing is desired.

The statement of facts (item 4) must be declared true under penalties of perjury. This may be done by adding to the appeal the following signed declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this protest and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

Your protest will be considered incomplete without this statement.

If an organization's representative submits the protest, a substitute declaration must be included stating that the representative prepared the protest and accompanying documents; and whether the representative knows personally that the statements of facts contained in the protest and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at [www.irs.gov](http://www.irs.gov), Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service  
EO Determinations Quality Assurance

Deliver to:

Internal Revenue Service  
EO Determinations Quality Assurance

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Kenneth Corbin  
Acting Director, Exempt Organizations

Enclosure, Publication 892